

Montana Attorney General's Office Student Loan Survey Report

September 27, 2007

I. BACKGROUND

The costs of higher education are soaring and grant and scholarship funds have not kept pace with rising tuition. Accordingly, a significant and growing number of students and their parents turn to loans to cover what they otherwise could not afford. Nationwide, two-thirds of all four-year college graduates have loan debt and the student loan business has swelled to become a more than \$85 billion a year industry.

In spite of the large number of students and families affected by the student loan industry, the procedures involved in applying for and getting a loan are enormously complex and confusing. Students and their parents are faced with an overwhelming array of loan possibilities and hundreds of potential lenders from which to choose. As a result, many students seek advice from the educational institutions they are attending. They trust that the institution will give them unbiased guidance on how best to finance their education. Unfortunately, in some states that advice has been anything but unbiased. Rather, it has been based on inappropriate relationships between educational institutions and lenders – relationships that financially benefited loan officers while hurting students who had to borrow money for their education.

Over the past year, several state attorneys general, most notably New York Attorney General Andrew M. Cuomo, have conducted investigations into the student loan industry. These investigations uncovered several significant, deceptive and illegal practices that appear to be widespread throughout the country and throughout many segments of the industry. These practices have adversely affected hundreds of thousands of student borrowers and their parents. Though many of these investigations crossed state lines, no Montana institution has been investigated or is alleged to have been involved.

II. PROBLEMS UNCOVERED IN OTHER JURISDICTIONS

A. Revenue Sharing

The most egregious practice uncovered is a form of kick-back scheme often referred to as “revenue sharing.” Revenue sharing is an arrangement under which a lender pays an institution of higher education a percentage of the principal of each loan a student at that institution takes out. This practice creates a substantial conflict of interest on the part of the institutions of higher education. When and if the institutions direct students to a specific lender, that referral should be based solely on the best interests of the students and parents who are taking out the loans. Under these revenue sharing arrangements, however, institutions have a financial interest in students or parents selecting a revenue sharing lender, regardless of whether that lender offers the best rates and service for the borrower.

B. Preferred Lender Lists

Many institutions of higher education create a list of recommended lenders and encourage students to borrow from the lenders listed. In some instances, these “preferred lender lists” contain dozens of lenders that meet certain minimal requirements. In other cases, educational institutions use the lists to recommend only a handful of lenders or even a single lender, as “preferred.” The benefits to the lenders of being included on these lists are considerable. Lenders on preferred lender lists typically receive up to 90 percent of the loans taken out by an institution's students and parents. With this loan volume comes vast profits for lenders on the preferred lists.

Despite the very significant role these lists play in influencing which lenders students and parents borrow from, many institutions have chosen not to inform students and parents about the criteria used to determine their recommended or preferred lender status. In some instances, institutions have gone so far as to actively conceal the less-than-ethical methods used to derive their recommendations. Some institutions failed to disclose potential or actual conflicts of interest on the part of their financial aid offices. These conflicts of interest arise from revenue sharing agreements or from other perks or consideration granted to schools and financial aid employees.

C. Improper Relationships Between Lenders and Financial Aid Officers

Investigation in other states has revealed conflicts of interest created by financial aid administrators who have held stock in a lender after being encouraged to purchase that stock by executives for the lender. In other cases, financial aid administrators have been paid for “consulting” with a lender, which in turn resulted in the lender being placed on the respective schools’ preferred lender lists.

Investigation also has revealed that many lenders have:

- paid travel expenses for financial aid officials to attend meetings and seminars in attractive locations, often after appointing an institution’s financial aid officials to an “advisory board” or “committee” sponsored by the lender;
- paid hundreds of thousands of dollars for printing services at the request of financial aid officers; and
- sent their own staff to assist school financial aid staff on school campuses.

As with revenue sharing agreements, lenders granted these types of benefits in an effort to encourage the institutions to steer students in their direction.

Another related problem is lenders agreeing to staff the school “call centers” that answer telephone or e-mail questions from students regarding financial aid, loans and lenders. Often call-center employees have not only failed to identify themselves as employees of a lender, but have been instructed to answer the phone in the institution’s name. Students calling or e-mailing their questions rightfully expected to receive unbiased information, but did not realize that the answers they got were from lender employees who had their employer’s – not the students’ – interests at heart.

D. Denial of Choice of Lender/Undisclosed Sale of Loans to Another Lender

Some institutions of higher education failed to make clear that borrowers have a right to select the lender of their choice, irrespective of whether that lender appears on any preferred lender list. Further, in many instances, institutions placed several lenders on their lists so borrowers believed that the list represented a real range of options. However, all or a number of the lenders on the list had prearranged among themselves to sell any loans to one of the lenders immediately after the loans had been dispersed to borrowers, creating the illusion of competition where there was none.

E. Quid Pro Quo “Opportunity Loans”

Investigators also discovered that lenders and colleges frequently entered into quid pro quo, high-interest, high-risk loans that hurt students. Under these types of agreements, lenders agreed to make loans up to a specified amount to students with poor or no credit history, or to international students whom the lender claimed would otherwise be ineligible for the lender’s alternative loan program. In exchange for the lender’s commitment to make such loans, the institution provided concessions or promises that adversely affected the interest rates, services or fees paid by other student borrowers.

III. MONTANA’S FORMAL INQUIRY

As in most other states, the Montana Attorney General’s Office has primary responsibility for consumer protection. In response to these disturbing findings in other states, Montana Attorney General Mike McGrath conducted a formal inquiry into the student loan industry in Montana. In June 2007, his office sent letters to all private colleges, public universities, technical institutions and tribal colleges in the state requesting extensive information about each institution’s relationships with its lenders. (Representative letter attached, Appendix A.)

The letter asked that they respond to 31 questions designed to determine the relationships that exist between the various entities that make up the student loan industry in Montana. A complete list of the questions begins on page 9 of this report.

IV. RESULTS OF MONTANA SURVEY

The letter sent by Attorney General McGrath requested a response by August 1, 2007. Contrary to what occurred in other states, Montana’s institutions of higher education cooperated and responded fully. However, all tribal colleges reported that they did not participate in any federal or state student loan program and therefore did not respond to the inquiry.

The results in Montana are reassuring for student borrowers and their families. The student loan industry in our state is a relatively open system that gives students access to all qualified lenders. There is no indication of schools or their employees benefiting financially in return for

recommending one lender over another and no indication of the abuses found in some other states.

A. Revenue Sharing

OTHER JURISDICTIONS: The most egregious problem discovered was revenue sharing agreements between institutions of higher education and lenders.

MONTANA: No Montana institution of higher education disclosed that it had any kind of revenue sharing relationship with a lender.

B. Preferred Lender Lists

OTHER JURISDICTIONS: Despite the significant role that preferred lender lists play in determining the lenders from which students and parents borrow, many institutions in other states have chosen not to inform their students and parents about the criteria used to formulate these lists and have actively concealed the methods used to derive their recommendations.

MONTANA: An examination of the preferred lender lists for Montana's institutions of higher education showed that they all contained numerous lenders that appear to represent all or most of the financial institutions with a presence in Montana. For example, Montana State University has 69 lenders on its preferred list and the University of Montana has 63 lenders on its list. The preferred lender list for Flathead Community College includes all lenders with a presence in that region.

In response to questions about how preferred lender lists are developed, all of Montana's institutions of higher education reported that no documents existed explaining the criteria for the selection of lenders for inclusion on or removal from their preferred lender lists.

Several institutions reported that they did not develop their own lists but used lists supplied by the Student Assistance Foundation (SAF). The SAF preferred lender list encompasses all lenders in Montana that:

- participate in the Federal Family Education Loan Program (FFELP) and
- are guaranteed by the Montana Guarantee Student Loan Program (MGSLP).

All institutions reported that they would and have used any lender that participates in FFELP and has electronic certification/electronic funds transfer capabilities with MGSLP. Further, most schools reported that if a student requested a particular lender, they have attempted and have often been able to accommodate that request. In summary, students and their parents in Montana do have the ability to choose from an extensive range of lenders.

C. Improper Relationships Between Lenders and Financial Aid Officers

OTHER JURISDICTIONS: Investigation revealed rampant conflicts of interest including financial aid administrators holding stock in lenders, being paid for "consulting" with a lender and

accepting expensive trips from lenders under the guise of serving on a lender's "advisory board," all in return for steering student borrowers to a particular lender.

MONTANA: The comprehensive nature of the preferred lender lists available through Montana's institutions of higher education make this kind of conflict of interest less likely than in other jurisdictions.

No Montana institution of higher education disclosed:

- any kind of relationship between an individual financial aid administrator and a lender that creates a real or apparent conflict of interest. For example, no institution disclosed that its financial aid administrator was paid to be a consultant by a lender in exchange for inclusion as a preferred lender at that institution.
- that a financial aid administrator purchased or was encouraged to purchase stock from a lender in exchange for some financial advantage for that particular lender.
- that lenders had paid travel expenses for school financial aid officials to attend meetings and seminars in attractive locations.
- that its financial aid administrators were participating in any advisory boards for lenders.

In response to questions about lender relationships with the institution, particularly with financial aid officials, most institutions provided information relating to their relationship with the Student Assistance Foundation (SAF). However, neither SAF nor the Montana Guaranteed Student Loan Program (MGSLP) are lenders for Montana student loans.

- SAF is a 501(c) (3) nonprofit company whose charitable mission is to provide students with the knowledge and tools to finance and pursue postsecondary education.
- MGSLP is the state agency that administers the Montana FFELP process.

Thus these relationships do not present the clear conflict of interest situations discovered in other jurisdictions.

Nearly every institution responding indicated that it had received nominal financial support in the form of meals, travel (car pooling) and minimal printing costs from SAF. All schools reporting indicated that:

- the financial support they received was for travel and meals at state and regional training meetings provided by SAF.
- the nominal printing costs reported were for the SAF-provided Federal Stafford Lender list for numerous schools, as noted in the Preferred Lender section of this report.
- they had received Acce\$\$ Grant money from SAF. Acce\$\$ grants provide financial aid to students whose financial needs are greater than federal student aid allows. The grants are awarded through school financial aid offices based on student need.

Numerous schools reported that, on occasion, various lenders including Wells Fargo and U.S. Bank, and guarantee agencies such as MGSLP, had provided meals during state organizational meetings. Most schools also reported receiving gifts such as note pads, sticky notes, or pens and pencils from lenders at training or organizational meetings. All schools reported that the lenders received no benefit from the institutions for these nominal gifts. Finally, numerous schools reported getting Professional Development Grants from MGSLP. Professional development grants are grants of financial support intended to reduce school costs associated with training for

financial aid administrators. Again, Montana's inquiry found none of the quid pro quo relationships discovered in other jurisdictions.

OTHER JURISDICTIONS: A related issue discovered in other jurisdictions was lenders agreeing to staff school "call centers" that answer telephone or e-mail questions from students regarding financial aid, loans and lenders. In these instances, the lender's employees often failed to disclose their affiliation with the lender or, even worse, indicated they were employees of the educational institution.

MONTANA: No Montana school reported that it used lenders to staff "call centers" or serve as temporary staff for financial aid offices. Several schools reported using SAF or MSGLP staff during the week of registration or during understaffed time periods during the year.

- Schools reported that the SAF employees answered general financial aid questions and assisted students in completing financial aid paperwork.
- All schools indicated that these SAF or MSGLP employees made no aid package decisions.
- Further, most schools reported that SAF either conducted or assisted in conducting all exit interviews. All schools reported that SAF employees conducted this exit counseling as SAF employees and the loan servicing agency, not as institution employees.
- Many schools also reported contracts with SAF for office space in or near the financial aid office.

The staff assistance reported was appropriate and does not raise the conflict of interest or misrepresentation issues found elsewhere.

D. Denial of Choice of Lender/Undisclosed Sales of Loans to Another Lender

OTHER JURISDICTIONS: Some institutions of higher education failed to inform borrowers that they have a right to select the lender of their choice, irrespective of preferred lender lists. Further, many of their preferred lender lists offered no real range of options, but just an illusion of competition.

MONTANA: Montana's institutions of higher education have comprehensive preferred lender lists. Most schools reported that they would attempt to work with any lender requested by students. No school reported knowledge of any arrangements among lenders for a particular lender to purchase loans from another lender.

The Montana Higher Education Student Assistance Corporation (MHESAC) eventually purchases the majority of Montana student loans from individual lenders. MHESAC is a nonprofit corporation created to provide FFELP capital in partnership with Montana lenders. Students borrow money from the individual lender of their choice and, after three to six months, that lender sells the loan to MHESAC (usually at par, for no more than the interest payments). This frees up capital so lenders can continue to loan money to Montana students. MHESAC purchases loans from all lenders. However, individual lenders in Montana are free to offer whatever deal they want to students, so students here do have a choice among lenders.

E. Quid Pro Quo “Opportunity Loans”

OTHER JURISDICTIONS: Investigators discovered that lenders and colleges frequently entered into quid pro quo, high-interest, high-risk loans that hurt students. Under these types of agreements, student borrowers generally picked up the tab for the high-risk loans lenders agreed to make.

MONTANA: No institution reported the existence of quid pro quo, high-interest, high-risk loan arrangements.

IV. CONCLUSIONS

It is clear from the Department of Justice inquiry that the deceptive and illegal conduct that has been found to exist in the school loan industry in some other states is not occurring in Montana’s institutions of higher education.

The response from University of Montana President George Dennison expressed “great confidence” in the relationships between the state guarantee agency (the Montana Guaranteed Student Loan Program) and the secondary market (the Montana Higher Education Student Assistance Corporation and the Student Assistance Foundation):

“The non-profit status of these agencies allows the use of tax-exempt bonding to fund most of the student loans during the repayment process. The lower cost of money has not only allowed MHESAC to offer one of the lowest cost student loan programs, but also to provide high quality personal service from personnel located in Montana to thousands of former students during the loan repayment process.”

However, as a note of caution, the higher education community in Montana is very small. The lenders, loan servicers, education and outreach providers, guarantors and the institutions and the officers who manage them are all heavily interconnected. For example, individuals who serve on the Board of Regents in Montana also serve on the boards of SAF and MHESAC. MHESAC is a lender and SAF may also become a lender.

V. RECOMMENDATIONS

Although the blatant conflicts of interest occurring elsewhere were not found in Montana, the potential for conflict is quite high due to these close and sometimes overlapping relationships. To avoid any potential for or appearance of conflict of interest, Montana’s institutions of higher education need to build appropriate safeguards into the school loan system.

We recommend that each Montana institution of higher education develop comprehensive guidelines explaining the criteria used to select lenders for inclusion on or removal from its preferred lender lists, as well as a clear, well-publicized disclosure that students can borrow from lenders who are not on the list.

In addition, by clearly distinguishing the distinct roles of the various entities within the student loan system and ensuring that officials within that system aren't wearing so many different hats that their responsibilities become blurred, our universities can help assure that the healthy student loan system we have in Montana today continues to benefit the students it serves.

Appendix A: SURVEY

Dear (Official):

As you are undoubtedly aware, concerns have been raised about the practices of certain student loan companies. Since the Attorney General's Office has primary consumer protection responsibilities in Montana, we are asking for your assistance in confirming for Montanans that their student loans have not been manipulated.

Information our office has received from the New York Attorney General identified practices which included loan companies offering or providing incentives in order to secure placement on schools' "preferred" lender lists, as well as other lender activity which created possible conflicts of interest and compromised the interests of individual student borrowers. With your cooperation in providing information about loan practices at your institution, we believe we can avoid the necessity of a formal civil investigative demand while assuring Montanans of the integrity of student aid in our state.

We request that you provide to us, at our Office of Consumer Protection, P.O. Box 200151, Helena, MT 59620-0151, on or before July 15, 2007, the following information and documents for the period January 1, 2004 to date, unless otherwise specified. Please respond for your affiliated campuses as well.

1. A current organizational chart of your school's financial aid office or offices;
2. A current directory or list of your school's financial aid officers and counselors;
3. Copies of your school's preferred lender lists. As used herein, "preferred lender list" refers to a list of lenders that have been selected by your school, which are recommended by your school, or which otherwise have a relationship with your school to provide loans to your school's students;
4. Copies of documents setting forth the school's criteria for selection of lenders for inclusion on "preferred lender lists" and for removal of lenders from such lists;
5. Copies of documents setting forth the school's procedures for selection and removal of "preferred lenders," including, but not limited to, use of requests for proposals ("RFPs");
6. A list of lenders that have offered your school compensation, equipment, or services for placement on preferred lender lists, including the type and amount of compensation, equipment or service offered, the name of the lender official at each of those lenders who made the offers;
7. Copies of documents (both hard copy and electronic) concerning gifts, compensation, equipment, services, expense-paid trips, meals, tickets or other incentives

or inducements by lenders to your school and/or to school officials or financial aid officers;

8. A list of lenders, if any, that have communicated with your school concerning override pools, opportunity funds, opportunity loans or other similar programs or mechanisms, including the names of the lender officials who participated in those communications. As used herein, “override pools,” “opportunity funds,” and “opportunity loans,” refer to any agreement, understanding or practice in which a lender applies more lenient loan underwriting criteria than it otherwise would to a certain class of loan applicants if the school meets certain milestones or metrics with respect to other loans with that lender, such as the number of loans initiated or in force, or the dollar amount of such loans, or where the lender agrees with your school to lend money to students outside the Federal Family Education Loan Program (“FFELP”), at the direction of your school, in exchange for your school dropping out of the federal direct loan program and/or marketing the lender’s separate FFELP loans to students;

9. Copies of documents concerning the use of override pools, opportunity funds, opportunity loans or other similar programs or mechanisms by lenders with your school;

10. A list of lenders, if any, which have asked your school’s financial aid officers or counselors to serve on their advisory panels or boards, and a list of such appointments that have been accepted, if any;

11. Does your school participate in the federal Direct Lending Program or the FFELP?;

12. A list of lenders, if any, that have communicated with your school concerning dropping out of the federal Direct Lending Program and entering the FFELP;

13. Copies of documents concerning communications with lenders regarding dropping out of the federal Direct Lending Program;

14. A list of lenders, if any, that your school has had service or other difficulties with, including the nature of the difficulties and the resolution, if any; and the name of the lender officials at each of those lenders who communicated with your school concerning those difficulties;

15. A list of lenders that have or had memoranda of understanding or contracts with your school;

16. Copies of documents concerning memoranda of understanding or contracts that your school has or had with lenders, including, but not limited to, proposed memoranda of understanding or contracts sent to or by your school;

17. Copies of documents concerning revenue sharing agreements, if any, that your school has or had with lenders, including, but not limited to, the actual agreements and proposed agreements sent to or by your school;

18. Copies of documents concerning “School as lender” programs, if any, including, but not limited to, documents evidencing the terms of such programs;

19. Copies of documents concerning compensation, gifts, meals, or expense-paid trips given by lenders to your school or its officials or financial aid officers either to attend National Association of Student Financial Aid Administrators

(“NASFAA”) and similar regional, state or local meetings or events or at such meetings or events;

20. Does your school financial aid office use temporary staff to assist with processing of and interfacing with students in connection with financial aid applications and awards? If so, what are the sources of such temporary staffing, including, but not limited to, student loan lenders and guaranty associations?;

21. Copies of documents concerning complaints by present and former student borrowers concerning lenders’ practices or policies with respect to repayment and/or defaults on student loans;

22. Copies of documents concerning more favorable loan terms secured by your school’s present and former student borrowers through use of lenders on your school’s preferred lender lists for FFELP, private and consolidation loans;

23. A chart showing the weighted average interest rates, origination fees, and other charges paid by your students for FFELP, private, and consolidation loans who use lenders on your school’s current preferred lender lists;

24. Copies of informational and marketing materials given or sent by your school to prospective and enrolled students concerning student loans for the period January 1, 2005 to date;

25. Lists of lenders, if any, whose student loan products are included in your school’s financial aid awards;

26. Examples of financial aid award letters for the full range of student loan options offered to students in your school and the corresponding applications for the student loans;

27. Copies of documents, if any, concerning student loan entrance counseling;

28. Does your school accept payment on credit cards for tuition, room and board and other education-related expenses?;

29. Does your school counsel students on not financing their education costs on credit cards? If so, provide documents concerning such counseling;

30. Provide a breakdown of the number of loans actually obtained by your school’s students for academic years 2005-2006 and 2006-2007 by loan type (*e.g.*, Stafford Subsidized, Stafford Unsubsidized, PLUS, Private and Institutional/School); school (*e.g.* Undergraduate College, Graduate School of Business, Law School, Medical School, etc.); and name of lending institution/loan provider; and

31. Does your school allow any lender to provide assistance with federal student loan exit interviews? If so, provide detailed information and documents on how the lender was chosen to provide that service and what information the lender provides to students.

While processing this request may entail some inconvenience, we know that you share our commitment to maintaining Montanans confidence in their student aid system. We thank you in advance for your cooperation.